

**FINAL REPORT
OF THE
INTERIM STUDY COMMITTEE ON
LIEN RECOVERY**



**Indiana Legislative Services Agency
200 W. Washington Street, Suite 301
Indianapolis, Indiana 46204**

November, 2002

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A copy of this report is available on the Internet. Reports, minutes, and notices are organized by committee. This report and other documents for this Committee can be accessed from the General Assembly Homepage at <http://www.state.in.us/legislative/>.

I. LEGISLATIVE COUNCIL DIRECTIVE

The Legislative Council directed the committee to study the merits of establishing a lien recovery fund to protect homeowners by providing a means of redress in the event that all debts owed on a home building or remodeling project are not paid by the general contractor (HR 71).

II. SUMMARY OF WORK PROGRAM

The committee met two times during the 2002 interim.

The first meeting was held at the State House on September 17, 2002. The topics of discussion were: (1) the Michigan lien recovery fund; (2) a subcontractor's duty to mitigate; and (3) amendments to the existing mechanic's lien law (IC 32-28-3).

The second meeting was held at the State House on October 17, 2002. The topics of discussion were the Utah lien recovery fund and further discussion of the issues presented during the September 17, 2002 meeting.

III. SUMMARY OF TESTIMONY

Michigan lien recovery fund

The committee heard testimony concerning the Michigan lien. (Established in 1982.) In Michigan, all licensed contractors are required to make a one time payment of \$50 to the lien recovery fund. The money accumulated in the fund is used to pay subcontractors and suppliers in the event that a property owner pays a general contractor who in turn fails to pay subcontractors and suppliers. The money in the fund is used to compensate the subcontractors and suppliers in lieu of requiring the property owner to in effect pay twice for the work.

The establishment of the fund required no seed money from the Michigan legislature. The law creating the fund provides for a special assessment in the event that money in the fund falls below \$1,000,000. There has been only one special assessment, which occurred in 1999. In addition to required contributions from licensed contractors non-licensed contractors and suppliers (roughly 30,000) voluntarily contribute to the Michigan fund. In Indiana general contractors and heating and air conditioning contractors are not licensed, so an Indiana fund would rely more heavily than Michigan on voluntary contributions.

The committee was presented information concerning problems with the Michigan fund. It was suggested to the committee that perhaps Michigan should not be responsible for defending the fund. (This would mean that the Michigan attorney general would not be a party to each action seeking recovery from the fund.) A more cost effective approach would be to allow the parties to the dispute to reach a settlement and then petition the fund once settlement is reached. Additionally, the Michigan fund allows a claimant to collect interest on claims. The payment of

interest and legal fees may be unnecessary because the recovering party initially made a poor credit decision by providing materials and labor. Interest awards are often quite high, and a more cost effective approach would limit awards to principal only or cap the amount of interest that the fund will pay a claimant. Finally, the creation of the fund has encouraged extensions of credit to unreliable risks with the understanding that the fund will serve as a back up.

Utah lien recovery fund

The committee heard testimony concerning the Utah lien recovery fund. The principles of the Utah fund are the same as the Michigan fund, however there are procedural differences between the two funds

The primary difference is the decision by Utah not to include the Attorney General as a party to a lien foreclosure action. In Michigan, the Attorney General is made a party to the action to foreclose the lien. (The inclusion of the Attorney General in these actions is responsible for increased costs in administration of the Michigan fund.) An action to foreclose on a lien in Utah proceeds in the same manner as a foreclosure action in Indiana. Each of the parties to the action (including the property owner) is responsible for legal expenses and costs. However, if during the course of the foreclosure action it is determined that the property owner paid the general contractor, then any damages awarded by the court come from the Utah lien recovery fund and not the property owner. Additional actions are available against a general contractor who fails to pay suppliers and subcontractors, such as: (1) license suspension; (2) a lawsuit against the general contractor for recovery of money paid from the fund; and (3) a civil fine or monetary penalty against the general contractor.

Two concepts were suggested to the committee in the event a lien recovery fund is adopted in Indiana. First, each general contractor and subcontractor would receive a unique identifying number upon payment for participation in the fund. The unique identifying number would be in the name of the individual, not the company. When a building permit is granted the unique identifying number of the contractor would be placed on the building permit. This would provide a mechanism for tracking participation in the fund and would avoid licensing of general contractors in Indiana. Second, because contractors are not licensed in Indiana an alternative source of funding may need to be considered vis a vis Michigan and Utah. One option is to charge a nominal fee for each building permit. This fee would be used to capitalize the lien recovery fund.

Suggested amendments to the existing mechanic's lien law (IC 32-28-3)

The committee heard testimony that suggested amendments to the existing mechanic's lien law. The following changes were suggested: (1) The time within which a notice of intention to hold a lien is required to be filed should uniformly be 60 days. (2) A subcontractor or supplier should be required to provide notice to a property owner if a general contractor is delinquent in payment. (3) A criminal penalty should be created for a general contractor who intentionally defaults on

payments to suppliers and subcontractors. (4) A pre-lien notification should be required for subcontractors and suppliers who do work on commercial projects. (5) A subcontractor or supplier should not be permitted to file a lien against a property owner if the property owner has fully paid a defaulting general contractor. (6) A property owner should not be required to pay attorney's fees if the property owner has not paid the full amount due under the contract for just cause.

IV. COMMITTEE FINDINGS AND RECOMMENDATIONS

The committee made the following recommendations:

Adoption of a lien recovery fund in Indiana is a potential solution to problems enunciated to the committee. However practical impediments exist that must be addressed before a fund can be adopted in Indiana, such as: (1) general contractors are not licensed in Indiana; (2) two companies in Michigan received 35% of the money paid out of the fund in 1999; (3) the method of dispute resolution needs to be decided; and (4) the proposed solution is a form of insurance. (Should other principles of insurance such as bonding be considered before this solution?)

Testimony suggested that a subcontractor or supplier should have a duty to mitigate damages when the subcontractor or supplier knows or should reasonably know that the general contractor is defaulting on payments.

A 30 day pre-lien notice is currently required for subcontractors and suppliers who perform alteration and repair work on owner occupied single and double family dwellings. The same pre-lien notice could be required for commercial projects.

The filing of a notice of intention to hold a lien could be reduced from 90 days to 60 days for commercial projects. However, subcontractors and material suppliers indicated that 60 days is not enough time to make a credit decision given a 30 day billing cycle. Some subcontractors and material suppliers advocated a 120 day period for filing a notice of intention to hold a lien.

The law regarding the payment of attorney's fees in foreclosure actions could be amended. The judicial interpretation of the attorney's fees statute (IC 32-28-3-14) has resulted in a property owner being responsible for full payment of the opposing parties' attorneys fees if the contract has not been paid in full. This interpretation applies even if money is withheld by the property owner because the general contractor has not performed under the contract.

All contracts between a general contractor and a homeowner for alteration and repair work could include language advising the homeowner of the right to a no lien contract. The advisement would serve as a warning to alert a consumer to potential problems associated with the filing of a lien.

At its final meeting the committee approved the draft version of this final report and gave

consent to the chairman and committee attorney to finalize the report. Each committee member was provided an opportunity to review the completed final report. No comments were received.

WITNESS LIST

John Barnett (Indiana Lumber and Builder's Supply Association, hereafter ILBSA)

Ray Moistner (ILBSA)

Belinda Wright (Assistant Administrator of the Michigan Lien Recovery Fund)

Tom Martin (Legislative Liaison for the Michigan Department of Consumer and Industry Services)

Joseph Beckman (lumberyard owner who works in Michigan and Indiana)

Brock Jordan (attorney with Rubin and Levin)

Representative Charlie Brown

Paul Shoopman (Dura Builders)